BANK ISLAM

APPLICATION OF SHARIAH CONTRACTS IN BANK ISLAM'S PRODUCTS AND SERVICES

بسم الله الرحمن الرحيم

السلام عليكم ورحمة الله وبركاته

and greetings to all.

Dear Readers,

On 1 July 1983, Bank Islam Malaysia Berhad (Bank Islam) made history by unveiling a system of banking that completely conforms to Shariah requirements. As the Islamic banking pioneer in Malaysia, Bank Islam is always committed to sharing with the public its knowledge and experience in Islamic banking products and services. This sincere intention is articulated in our Vision Statement, in which we aim to be 'the global leader in Islamic banking'. We define 'global leader' as the ultimate guidance or source of reference for innovative Shariah-based products and services.

As part of our efforts in turning this vision into reality, we aspire to develop Bank Islam as a `Knowledge Centre' for Islamic finance which is characterised, among others, by sharing with our valued readers how relevant Shariah contracts are applied in our products and services. We sincerely hope that the publication of this booklet, which contains diagrammatic descriptions of our selected products will help readers to have a better understanding of the Muamalat terminology as well as of Bank Islam's products and services.

In addition, as part of fulfilling one of our Mission Statements i.e. to continuously develop and innovate universally accepted financial solutions, we have established a dedicated Product Development Department which focuses on spearheading the development and innovation of products and services in collaboration with other business units within the Bank.

Recognising the dynamism of Islamic finance, its vast potential and increasing acceptability globally irrespective of religious convictions, we will further explore and develop new products that are universally accepted. Last but not least, we welcome fresh ideas or any comments at all times, which are vital in our quest to continuously enhance existing, or to develop entirely brand-new innovative products that meet customer needs and expectations.

Thank you.

وبالله التوفيق والهداية والسلام عليكم ورحمة الله وبركاته

DATO' SRI ZUKRI SAMAT
Managing Director

About Bank Islam

Bank Islam emerged as Malaysia's maiden Shariah-based financial institution when it commenced operations in July 1983. Since then, we have played a key role in developing the country's Islamic financial services industry (IFSI) to the point that Bank Islam is acknowledged as the forerunner of Islamic banking in Malaysia. We have also played a leading role in promoting the "export" of Malaysia's brand of Islamic finance to other markets especially in the Asian region. Bank Islam has since developed into a well-established and universally recognised brand, in synch with its vision to become `the global leader in Islamic banking'. As a testament of this pioneering role, Bank Islam was awarded the Reader's Digest Platinum Award 2009 for being the Most Trusted Brand for Islamic Financial Services.

From only RM80 million initially, Bank Islam's paid-up capital swelled to RM1.73 billion as at end-June 2009. This has enabled an exponential growth of our assets and supported other expansion initiatives in particular branch network and delivery channels. Today, our network comprises 100 branches and 730 self-service terminals nationwide. We offer a comprehensive list of more than 50 innovative and sophisticated Islamic financial products and services, comparable to those offered by our conventional counterparts.

In Malaysia and the four corners of the globe, modern-day Islamic finance has observed growing acceptance, recognition and popularity thanks to its universal values which include among others, equity, fairness and transparency apart from its proven resilience to withstand shocks. To capitalise on this encouraging trend, Bank Islam has planned to set up another 25 branches in the next 3 years and to explore new markets whenever there is feasible opportunity. To unlock the huge white-labelling potential, Bank Islam has recently participated in the establishment of Amana Bank Limited, Sri Lanka's first Islamic bank by acquiring a significant stake.

Similarly, the type of Shariah contracts applied in Bank Islam's products has evolved from *BBA*, *Wadiah* and *Mudharabah* contracts for traditional financing and deposits to the application of various Shariah contracts including *Ijarah*, *Murabahah* and *Musharakah* for more complex structures including derivatives. As part of the initiatives to share and impart our knowledge and expertise in Islamic finance, we plan to offer consultancy and advisory services related to the implementation of Islamic finance solutions and/or to ensure that financial products and services that clients carry out are Shariah compliant.

Contents

Promotion of Islamic Muamalah

عَنْ مُعَاذِ بْنِ جَبَلٍ ، قَالَ : قَالَ رَسُولُ اللَّهِ صلى الله عليه وسلم : إِنَّ أَطْيَبَ الْكَسْبِ كَسْبُ التُّجَّارِ
الَّذِينَ إِذَا حَدَّثُوا لَمْ يَكْذِبُوا ، وَإِذَا ائْتُمِنُوا لَمْ يَخُونُوا ، وَإِذَا وَعَدُوا لَمْ يُخْلِفُوا ، وَإِذَا اشْتَرَوْا لَمْ يَذِمُّوا
، وَإِذَا بَاعُوا لَمْ يُطْرُوا ، وَإِذَا كَانَ عَلَيْهِمْ لَمْ يَمْطُلُوا ، وَإِذَا كَانَ لَهُمْ لَمْ يُعَسِّرُوا
(رواه البيهقي)

From Mu'az bin Jabal, he narrated that Rasulullah SAW said:
Surely the best work is the work of traders who; when they speak never lie and when given trust never betray and when promising never break and when buying never denounce and when selling never exaggerate and when performing obligations never delay and when deserve for anything never put in hardship.

(Narrated by al-Baihaqi)





Glossary of Muamalat Terms

Arbun

Security deposit paid in advance as part payment of the purchase price of an asset purchased. The deposit is forfeited as gift (*hibah*) by the seller if the buyer does not meet his/her obligation to complete the purchase of the asset.

Al-Awfar

An Arabic word that means prosperity.

An Najah

An Arabic word that means successful.

Bai' Bithaman Ajil (BBA)

A contract of sale on a deferred payment basis within an agreed payment period.

Bai' Inah

A financing facility involving two separate sale and purchase contracts of the same asset and it can be in the following two arrangements:

- A financier sells an asset to a customer in deferred payment terms. Immediately thereafter, the financier repurchases the same asset from the customer on a cash basis at a price lower than that of the deferred payment sale.

- A financier buys an asset from a customer on a cash basis. Immediately thereafter, the financier sells back the same asset to the customer in deferred payment terms at a price higher than that of the cash sale.

Hamish Jiddiyah

Security deposit; a certain amount of money taken from a customer, who places an order to purchase, as a security for his/her promise.

Ijarah

A contract whereby a lessor (owner of an asset) leases out his/her asset to a customer/lessee at an agreed rental payment and pre-determined lease period upon the *aqd* (contract). The ownership of the property remains with the lessor while the lessee only owns the right to use the property.

Ijarah Thumma Bai'

An *Ijārah* contract to be followed by a sale contract. Upon expiry of the leasing period, the lessee enters into a contract to purchase the property from the owner at an agreed price. In certain jurisdictions, the same is called *Ijārah Muntahiah Bit-Tamlīk*.

Istisna'

An order sale used mainly to finance the purchase of assets that are not yet in existence or under construction.

Mudharabah

An agreement between a capital provider (*Rabbul māl*) who provides 100% capital for a business/project and an entrepreneur (*Mudhārib*) who manages/runs the business/project applying his expertise. Under this contract, the resulting profit is to be shared between them according to a pre-agreed ratio while any loss is to be borne solely by the capital provider.

Mudharabah Muqayyadah

An agreement whereby a capital provider restricts the utilisation of his/her funds by an entrepreneur according to specified time, types of business, business place or types of services.

Mudharabah Mutlaqah

An agreement in which a capital provider does not restrict the management of his/her funds in any way. The entreprener or *Mudharib* is given full discretion to manage the funds without limitations.

Murabahah

The sale of goods at an agreed price. Such contract is valid with the condition that the price, other costs, and the profit margin of the seller are disclosed at the time of the sale agreement.

Murabahah Purchase Orderer (MPO)

This involves an order or promise by a customer to purchase goods from the Bank which can be binding or non-binding. An MPO will be followed by a normal *Murabahah*.

Musawamah

A general kind of sale in which the price of a commodity to be traded is bargained between the seller and the purchaser without any reference to the acquisition cost incurred by the seller.

Musharakah

A contract between two or more parties to contribute capital in various proportions to a partnership. Profits generated by the partnership are shared in accordance with the terms of *Mushārakah* contract while losses are shared in proportion to the respective contributors' share of the capital.

Musharakah Mutanaqisah

Diminishing *Mushārakah* which allows equity participation as well as sharing of profits in a pre-agreed ratio and sharing of losses on a pro-rata basis. This mechanism allows the Bank to progressively reduce its equity in an asset, ultimately transferring ownership of the asset to a customer/partner. The contract provides for payment to purchase equity shares held by the Bank, over and above the profit paid to the bank. The Bank will gradually pare down its shares until zero, thus ending the partnership.

Shariah

Islamic laws relating to all aspects of human life established by Allah for his servants. The laws are divided into three categories namely related to belief (*aqīdah*), related to deeds (*fiqh*) and related to ethics (*akhlāq*). In the context of Islamic finance, *Sharīᶜah* is another word for Islam.

Sukuk

Asset-backed bonds which are structured in accordance with Shariah. *Sukūk* evidencing an undivided pro-rata ownership of underlying asset. Most of these bonds may be traded in the market, depending upon how they are structured; at par, premium or discount.

Tawarruq

The purchase of a commodity (i.e. the subject matter of *Tawarruq*) on a deferred payment basis by way of either *Bai' Musāwamah* or *Murābahah*. The commodity is then sold for cash to a party other than the original seller.

Wa'ad

A promise, which is commonly applied in Shariah contracts such as *Murabahah* or *Istisna'*. The promise can be either binding or non-binding on the promisor, subject to its nature. A binding promise is known as *Wa'ad Mulzim*.

Wadiah

Safe custody. Originally, safe custody is referred to as *Wadī'ah yad amānah*, i.e. trustee custody. According to *Sharīah*, the trustee custodian has the duty to safeguard the property held in trust.

It changes to *Wadī'ah yad dhamānah* (guaranteed custody) when the trustee/custodian violates the condition to mere safekeeping of the property such as if he imposes a safekeeping fee on the owner or he utilizes the property for his own benefit etc. The custodian then has to guarantee the property.

Wiqa

An Arabic word that means protection/preservation.

Significance of Abstaining *Riba* in Business Transactions

عَنْ سَمُرَةَ بْنِ جُنْدُبٍ رضى الله عنه – قَالَ قَالَ النَّبِىُّ — صلى الله عليه وسلم – « رَأَيْتُ اللَّيْلَةَ رَجُلَيْنِ أَتَيَانِى فَأَخْرَجَانِى إِلَى أَرْضٍ مُقَدَّسَةٍ ، فَانْطَلَقْنَا حَتَّى أَتَيْنَا عَلَى نَهَرٍ مِنْ دَمٍ فِيهِ رَجُلٌ قَائِمٌ ، وَعَلَى وَسَطِ النَّهْرِ رَجُلٌ بَيْنَ يَدَيْهِ حِجَارَةٌ ، فَأَقْبَلَ الرَّجُلُ الَّذِى فِى النَّهَرِ فَإِذَا أَرَادَ الرَّجُلُ أَنْ يَخْرُجَ رَمَى الرَّجُلُ بِحَجَرٍ فِى فِيهِ فَرَدَّهُ حَيْثُ كَانَ ، فَجَعَلَ كُلَّمَا جَاءَ لِيَخْرُجَ رَمَى فِي فِيهِ بِحَجَرٍ فَيَرْجِعُ كَمَا كَانَ ، فَقُلْتُ مَا هَذَا فَقَالَ الَّذِى رَأَيْتَهُ فِى النَّهَرِ آكِلُ الرِّبَا .

(رواه البخاري)

From Samurah bin Jundub, he narrated that the Prophet SAW said, "This night I dreamt that two men came and took me to a Holy land whence we proceeded on till we reached a river of blood, where a man was standing, and on its bank was standing another man with stones in his hands. Every time the man in the middle of the river tried to come out, the other threw a stone into his mouth and forced him to go back to his original place. So, whenever he tried to come out, the other man would throw a stone in his mouth and force him to go back to his former place. I asked, "Who is this?". I was told, "The person in the river was a Riba-eater".

(Narrated by al-Bukhari)





Milestones Of Shariah Contract Application

1983 - 1990

- *Wadiah* Current Account
- *Wadiah* Savings Account
- *Mudharabah* Financing
- *Ijarah* Financing
- *BBA* Financing
- *Mudharabah* Investment Account
- *Murabahah* LC
- *Musharakah* LC
- *Wakalah* LC
- *Bai' Dayn* Trade Financing
- *Murabahah* Working Capital Financing

1991 - 2000

- *Sarf* Forex
- *Mudharabah* Interbank Investment
- *Musharakah* Financing
- *Bai' Inah* Credit Card

2001 - 2005

- *Bai' Dayn, Musharakah, Mudharabah* ICDO
- *Wadiah* Debit Card
- *Bai' Inah* Overdraft
- *Bai' Ina*h Commercial Credit Card
- *Bai' Inah* Personal Financing
- *Bai' Inah* Negotiable Instrument of Deposit (NID)

2006 - 2008

- Commodity *Murabahah* Profit Rate Swap
- Commodity *Murabahah* Forward Rate Agreement
- *Ijarah* Rental Swaps-i
- *BBA* Floating Rate
- *Murabahah* Floating Rate
- *Istisna'* Floating Rate
- *Ijarah* Floating Rate
- *Mudharabah* Capital Protected Structured Investment
- *Bai' Inah* Floating Rate NID
- *Mudharabah* Savings Multiplier Deposit
- *Tawarruq* Commodity Undertaking

2009 onwards

- *Tawarruq* Business Financing
- *Tawarruq* Personal Financing
- *Tawarruq* Credit Card
- *Murabahah* with Novation Agreement
- *Istisna'* convertible to Ijarah
- *Bai'* and *Ijarah* (Sale and Lease Back)
- *Musharakah Mutanaqisah*
- *Istisna'* with Parallel *Istisna'*

Note - This listing is far from being exhaustive. Although they have been developed and/or approved, some products have yet to be rolled out at the time of publication of this document.

Encouragement of Continuous Learning and Education

مَنْ سَلَكَ طَرِيقاً يَبْتَغِي فِيهِ عِلْماً سَهَّلَ اللهُ لَهُ طَرِيقاً إِلَى الجَنَّةِ، وَإِنَّ المَلاَئِكَةَ لَتَضَعُ أَجْنِحَتَهَا لِطَالِبِ العِلْمِ رِضاً بِمَا يَصْنَعُ ، وَإِنَّ العَالِمَ لَيَسْتَغْفِرُ لَهُ مَنْ فِي السَّمَاوَاتِ وَمَنْ فِي الأَرْضِ حَتَّى الحِيتَانُ فِي المَاءِ ، وَفَضْلُ العَالِمِ عَلَى العَابِدِ كَفَضْلِ القَمَرِ عَلَى سَائِرِ الكَوَاكِبِ ، وَإِنَّ العُلَمَاءَ وَرَثَةُ الأَنْبِيَاءِ ، وَإِنَّ الأَنْبِيَاءَ لَمْ يُوَرِّثُوا دِينَاراً وَلاَ دِرْهَماً وَإِنَّمَا وَرَّثُوا العِلْمَ ، فَمَنْ أَخَذَهُ أَخَذَ بِحَظٍّ وَافِرٍ .

(رواه أبو داود والترمذي)

Whoever seeks the path towards gaining knowledge, Allah will ease him on his path towards Paradise. And verily the angels will lower their wings to those gaining knowledge as they bless his effort. And verily, those who have knowledge will attain prayers for forgiveness onto him from whoever lives in the skies and earth including fishes in the sea. And the prominence of a person who has knowledge against a worshiper is akin to the moon's fame against all sparkling stars. And verily, Islamic scholars are the legacy of the Prophets'. And verily the Prophets will not inherit any dinar and dirham (wealth and prosperity), but knowledge (Islamic teachings). Thus, whoever takes it (knowledge), he indeed obtains great returns.

(Narrated by Abu Daud and al-Tirmizi)





Highlights On Bank Islam's Products And Services

SALIENT FEATURES

- The objective is to provide customers with a 'credit line' to be used for personal consumption.
- The *Shariah* contract used was *Bai' Inah* and Bank has recently introduced *Tawarruq*-based cards.
- The 'credit line' available for utilisation by customers is not in the form of lending but in the form of *Wadi'ah* savings account. The fund in this account arises from the *Bai' Inah* or *Tawarruq* transactions. Therefore, as opposed to a conventional credit card, Bank Islam Card is similar to a debit card.
- No elements of compounding finance charges involved.
- Customers also enjoy 'free' profit rate for 20 days from the day of 'charging' the card.

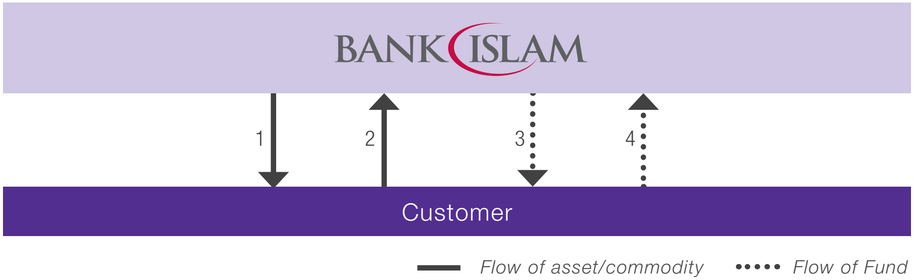
PROCESS FLOW OF BAI' INAH TRANSACTIONS

1. The Bank sells an identified asset to the customer on a deferred basis at cost plus profit, which is equivalent to the maximum amount to be paid by the customer.
2. The customer then re-sells the same asset to the Bank on a cash basis, which is equivalent to the limit of the card.
3. The proceeds are then disbursed into a *Wadi`ah* savings account designated to the customer. The amount becomes the card limit that may be utilised by the customer as and when he desires.
4. The customer pays the Bank the amount he utilises either on a monthly basis (by paying a specified minimum amount) or the full amount.

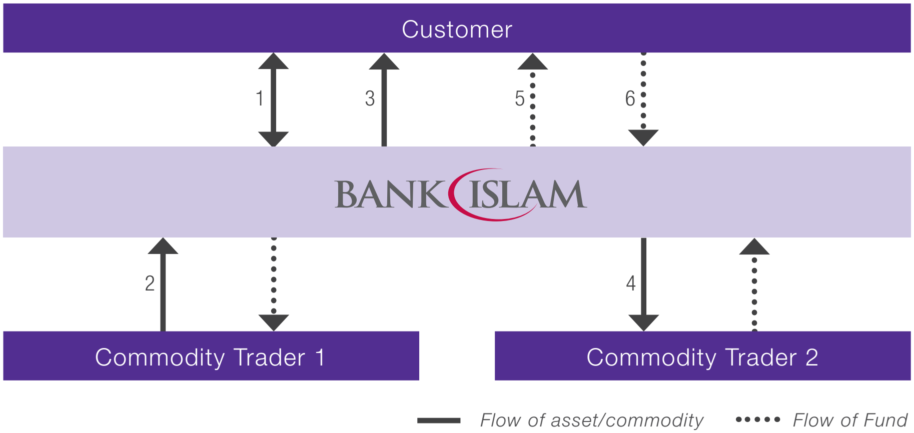
PROCESS FLOW OF TAWARRUQ TRANSACTIONS

1. The customer enters into an arrangement with the Bank whereby the customer promises to buy a specified commodity from the Bank.
2. The Bank buys a specified commodity from Trader 1 on a spot basis.
3. The Bank sells the same commodity to the customer on a deferred basis at cost plus profit. The customer also appoints the Bank as his agent to sell the said commodity.
4. As agent, the Bank sells the same commodity to Trader 2 on a spot basis.
5. The Bank pays the selling proceeds to the customer by crediting his designated *Wadi`ah* account and the amount becomes his card limit.
6. The customer pays the Bank the amount he utilises either on a monthly basis (by paying a specified minimum amount) or the full amount.

PROCESS FLOW OF BAI' INAH TRANSACTIONS



PROCESS FLOW OF TAWARRUQ TRANSACTIONS



SALIENT FEATURES

Objective

- The customer, being a business entity (product known as Business Financing-i) or an individual (product known as Personal Financing-i) needs cash to meet his/her business or personal requirements.

Consolidation of debts

- Specifically, a customer with PF-i can pay off all or part of his/her debts using the proceeds of the PF-i to ease his/her financial burden with lower monthly obligations.

Tawarruq

- The Shariah concept used is *Tawarruq* which involves commodity *Murabahah* transactions as shown diagrammatically below.

TRANSACTION FLOW

1. A customer enters into an arrangement with the Bank whereby the customer promises to buy a specified commodity from the Bank. The customer also appoints the Bank as his agent to sell the said commodity.

2. The Bank buys a specified commodity from Trader 1 on a spot basis.

3. The Bank sells the same commodity to the customer on a deferred basis at cost plus profit.

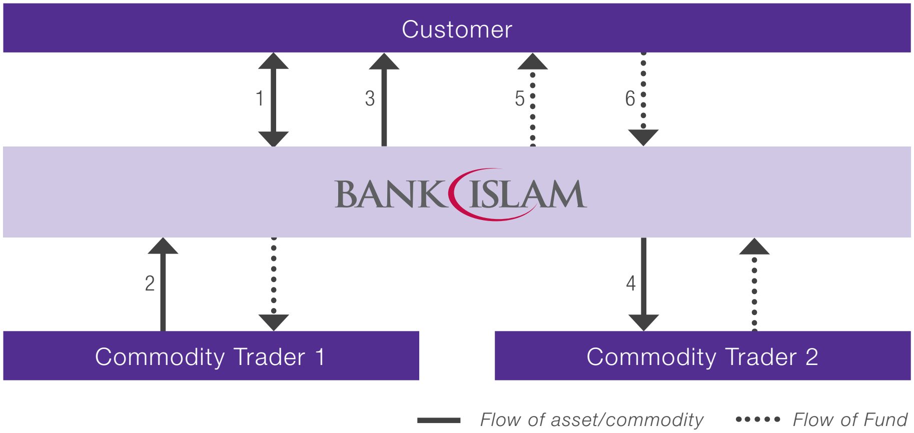
4. As an agent, the Bank sells the same commodity to Trader 2 on a spot basis.

5. The Bank pays the customer the selling proceeds lump sum.

6. The customer pays the Bank the purchase price of the commodity on an installment basis.

7. The transaction results with the customer receiving cash to be used for his/her business or personal requirements.

Business Financing-i (BF-i) & Personal Financing-i (PF-i)



SALIENT FEATURES

Objective

- The customer intends to purchase a vehicle for personal use.

Shariah Contract

- The Shariah contract applied is *Bai' Bithaman Ajil* (*BBA*). The application of *BBA* in this product is similar to *Murabahah* Purchase Orderer (MPO)

- The Bank, before entering into a *BBA* contract with the customer, purchases the vehicle from a third party i.e. the car dealer.

- The purchase by the Bank arises from the order or request made by the customer.

- The vehicle belongs to and registered in the name of the customer.

Power of Attorney

- The customer empowers the Bank to deal with the vehicle in the event of default by the customer.

PROCESS FLOW OF *BBA* TRANSACTIONS

1. The Bank appoints a Car Dealer as its panel dealer and agent who will subsequently appoint a prospective buyer as the Bank's agent to purchase the car, subject to terms & conditions (T&C).

2. When the customer decides to buy a specified car, the Car Dealer will appoint him/her as a purchasing agent of the Bank but subject to the T&C and he/she will subsequently place an order to purchase the car.

3. The customer submits an application to purchase the car to the Bank. This application can also be made through the Car Dealer.

4. If the application is approved by the Bank, the Bank will notify the customer of such approval.

5. The Bank pays the Car Dealer the agreed purchase price.

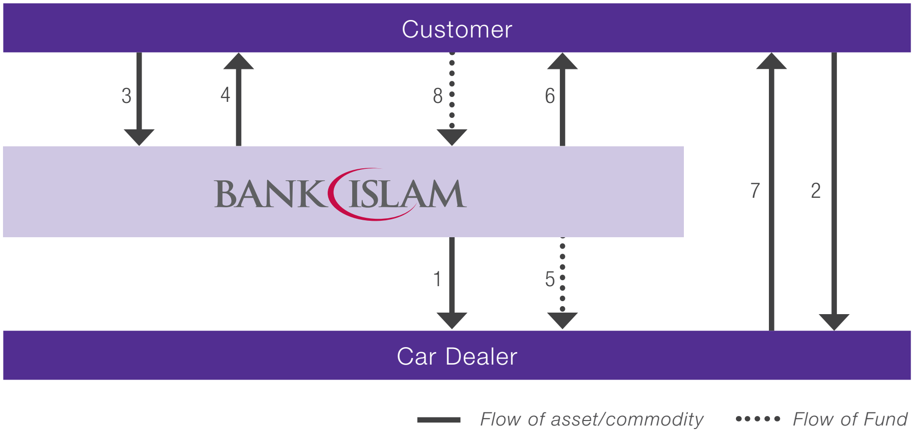
6. The Bank then sells the car to the customer on deferred terms at cost plus profit.

7. As an agent of the Bank, the Car Dealer delivers the car to the customer and the vehicle will be charged to the Bank as collateral (by way of ownership claim).

8. The customer pays the Bank the price of the car by way of monthly instalments.

Most of other Islamic banks in Malaysia however apply the AITAB contract for such vehicle financings.

Vehicle Financing



SALIENT FEATURES

- A customer purchases a house from the Bank under the *Bai' Bithaman Ajil* (*BBA*) contract whereby the payment is on deferred terms or usually by way of monthly installments.
- Before the Bank can sell the asset to the customer, the Bank has to either first purchase the asset from the customer or enter into a novation agreement with the customer and the developer.
- Moving forward, the Bank will also introduce home financing products based on the *Musharakah* contract. Under the *Musharakah Mutanaqisah concept*, the Bank will allow customers to buy out the Bank's share in the asset progressively.
- One of the distinctive traits of the Bank's home financing is the 'payment holiday' whereby customers have the option to skip paying installment for the months of November and December every year.

BBA PROCESS FLOW

1. A customer purchases a house from a developer/vendor, paying deposit or down payment.

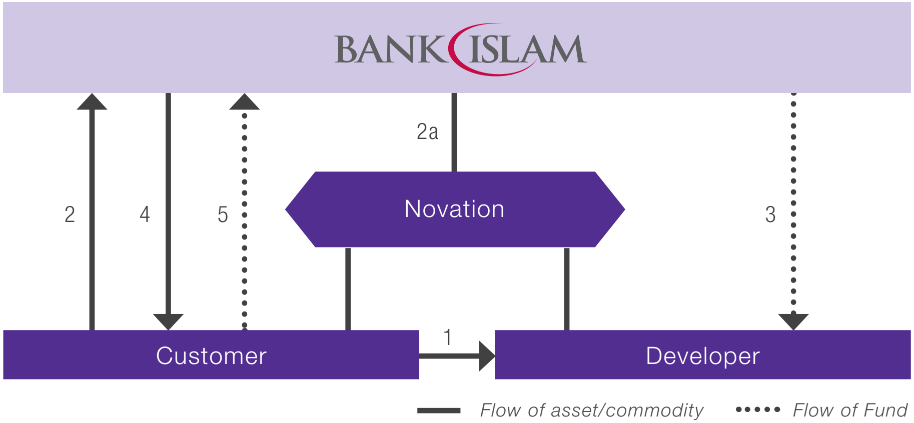
2. The customer approaches the Bank to finance the house purchase. If the Bank approves the financing, an Asset Purchase Agreement will be executed where the Bank purchases the asset (house) from the customer on a cash basis.

2a. Alternatively, the rights of the Bank over the asset can be obtained via the execution of a tripartite novation agreement involving the Bank, the customer and the developer.

3. The Bank pays the purchase price directly to the developer as settlement of the customer's house purchase from the developer.

4. The Asset Sale Agreement will be executed, in which the Bank will sell the asset to the customer on deferred terms at cost plus profit.

5. The customer will pay the sale price on an installment basis.


BANK ISLAM
2a
Novation
2
4
5
3
1
Customer
Developer
Flow of asset/commodity
Flow of Fund

SALIENT FEATURES

- A savings-cum-investment type of deposit based on the *Mudharabah* contract or profit sharing basis.

- On a quarterly basis, a draw will be done and cash prizes will be paid to winners. The draw concept is not against Shariah rules and it has been approved by the Bank's Shariah Supervisory Council.

- The cash prizes will be as follows:
  - 1st prize - RM100,000
  - 2nd prize – RM10,000
  - 3rd prize – RM5,000
  - 4th prize - RM1,000
  - 5th prize – RM500
  - 6th prize – RM250
  - 7th prize - RM100

- To be eligible, the minimum deposits are as follows:
  - Savings RM100
  - Investment RM1,000 (1 month)
    RM500 (3 months – 60 months)

- Apart from the potential of winning prizes, customers will also enjoy monthly profits on their deposits according to the agreed profit sharing ratio.

PRODUCT PROCESS FLOW

1. A customer places deposits with the Bank under the contract of *Mudharabah*.

2. The Bank invests the funds in activities permitted by *Shariah*.

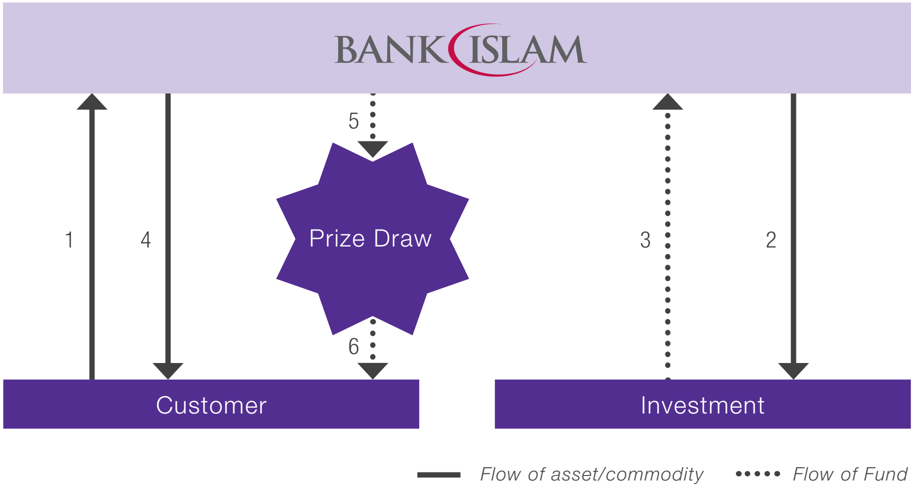
3. The Bank receives income from these investments.

4. The Bank pays profits to the customer on a monthly basis.

5. The Bank conducts prize draw on a quarterly basis.

6. Draw winners will receive cash prizes which come from the Bank's share of the profit generated from investments of *Mudharabah* funds.

Al-Awfar Deposit



SALIENT FEATURES

- A structured investment product comprising *Islamic* Negotiable Instrument of Deposits (NID) with a floating rate of return based on the *Mudharabah* contract.

- *Mudharabah Muqayyadah*
    - A customer and the Bank enter into a *Mudharabah* contract whereby the customer becomes *Rabbul Mal* and the Bank becomes *Mudharib*.

    - It is a restricted *Mudharabah* because funds provided by the customer will be invested in specific securities namely Discounted Islamic Negotiable Instruments (INIs) for capital protection and a basket of stocks for yield enhancement.

    - Profit from the investment is distributable between *Rabbul Mal* and *Mudharib* based on an agreed profit sharing ratio.

- Capital Protection
    - Part (90%) of the capital provided by the customer is invested in INIs that provide fixed maturity value equivalent to the full capital amount.

    - Upon maturity, the customer will get at least an amount that is equivalent to his/her initial capital (100%).

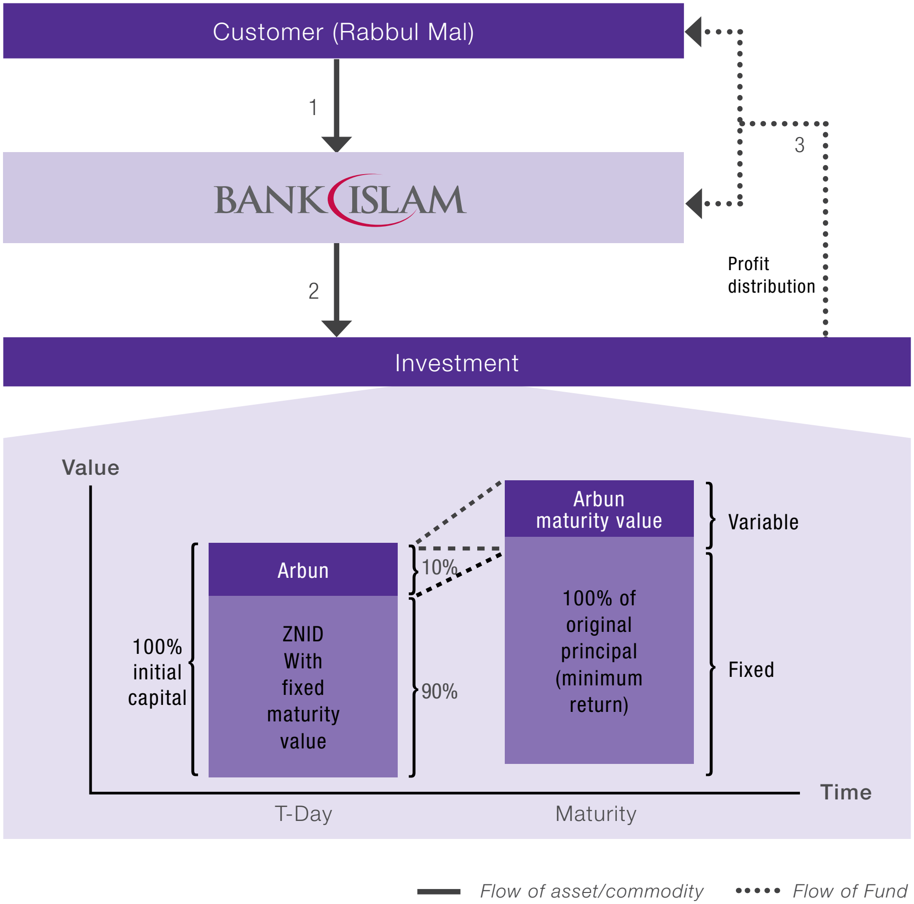
    - The capital protection is only applicable if the investment is kept until maturity.

- Yield Enhancement
    - Another part (10%) of the capital is invested in equity basket (Al-Baraka Islamic Population Index) through an agent using the *Arbun* mechanism.

    - The *Arbun* represents initial payment amount for the purchase price of the index.

    - Upon maturity, if the Bank decides to complete the purchase, the Bank has to pay the remainder of the purchase. The Bank will subsequently sell the index in the market and the profit derived from the sale will be shared accordingly with the customer.

    - If the Bank revokes the purchase, the initial payment amount will be forfeited by the seller (through the agent).



THE MECHANICS OF *AN NAJAH*

1. The customer and the Bank enter into a *Mudharabah* contract whereby the customer agrees to provide the capital.

2. The Bank invests 90% of the capital by purchasing INIs. The remainder is used to purchase an equity basket using the *Arbun* mechanism.

3. Profits are distributed based on an agreed profit sharing ratio.

SALIENT FEATURES

Objective

- Formation of a partnership between the Bank that assumes the role as a capital provider (*Rabbul Mal*) and a customer as an entrepreneur (*Mudharib*) who is expected to perform the best of his/her ability to generate profit out of the capital provided.

Profit Sharing Ratio

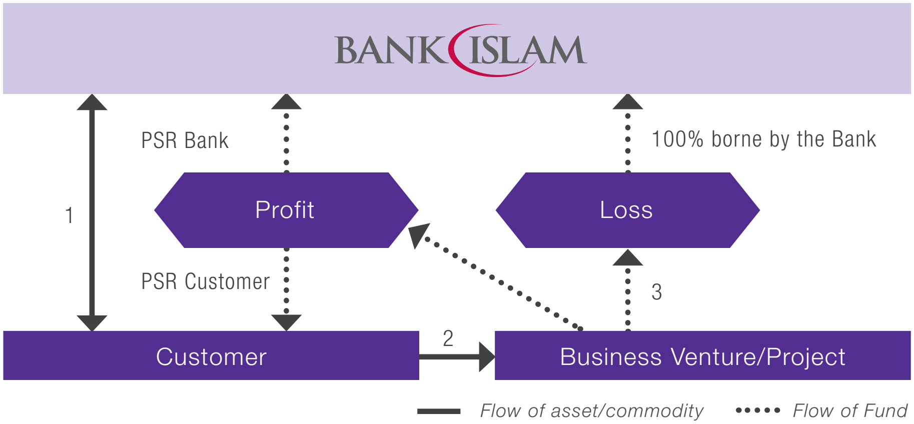
- Profit is shared between the capital provider and the entrepreneur according to a pre-determined profit sharing ratio (PSR). The PSR has to be mutually consented upon and explicitly stated at the time of contracting (*aqad*) and has to be in proportion/ percentage terms of the profits. In a reverse condition where a financial loss occurs under the *Mudharabah* financing, the Bank will bear the loss. However, if the loss is caused by negligence, mismanagement or breach of contracted terms by the customer, then the customer is liable for the loss.

Types of Mudharabah

- Restricted *Mudharabah* (*Mudharabah Muqayyadah*) where the Bank will impose specific terms and conditions to the customer in running the business venture.

- Unrestricted *Mudharabah* (*Mudharabah Mutlaqah*) is the reverse of the above whereby there will be no specific terms and conditions imposed by the Bank on the customer.

Mudharabah Financing



1. The Bank (as *Rabbul Mal*) provides capital to its customer (as *Mudharib*) to undertake a business/project venture.

2. *Mudharib* manages the capital/business.

3. Profits are to be shared in accordance with the terms of the *Mudharabah* agreement while losses, if any, are to be borne solely by the *Rabbul Mal* so long as it is not caused by negligence, mismanagement or breach of contract terms.

SALIENT FEATURES

Objective

- A partnership established between the Bank and the customer where both partners mutually agree to contribute capital for a specific project and share any profit or loss arising from the business activities according to a pre-agreed ratio.

Profit-and-Loss Sharing

- The profit from the *Musharakah* business is shared between the Bank and the customer based on an agreed profit-sharing ratio (PSR) and in the event of loss, it is to be shared based on the capital contribution ratio (CCR).

1. The Bank and the customer contribute capital to a business/project venture.
2. Partners run the business/project.
3. Profits or loss arising from the business/project is to be shared in accordance with the agreed PSR or CCR respectively.

SALIENT FEATURES

Definition

- An Islamic forward rate agreement which is an agreement to exchange profit rates on a specified future date by referring to an agreed benchmark, implemented through the execution of a "*commodity Murabahah*" contract.

Objectives

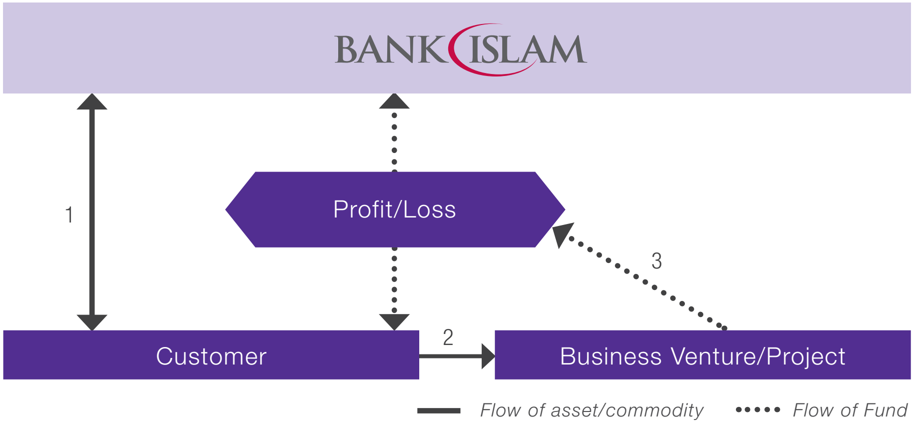
- To serve as a hedging instrument in asset and liability management against market uncertainty.

Example

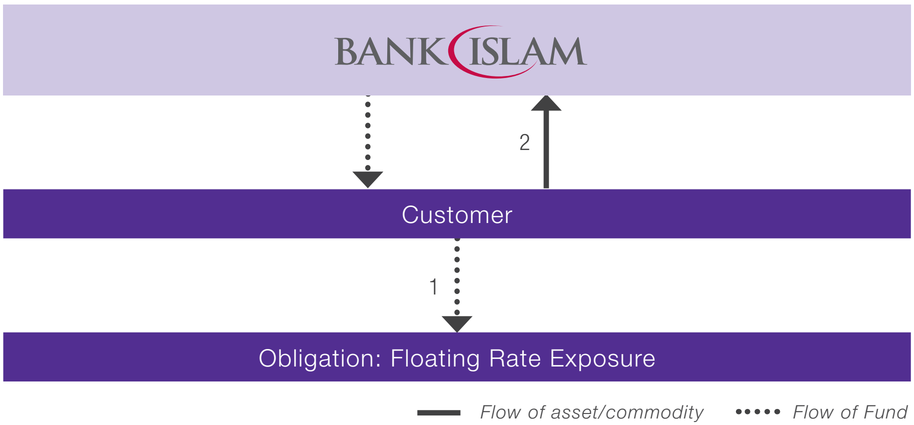
- A customer has a 3-month floating rate exposure in 1 month's time and wishes to hedge the exposure by locking in the floating rate now. By entering into a WFRA, the customer is hedged.

1. A customer has a short-term floating rate exposure in the near future.
2. By entering into the WFRA with Bank Islam, the customer is hedged. The customer locks in the floating rate exposure by paying a fixed profit rate to and receiving a floating profit rate from Bank Islam.

Musharakah Financing



Wiqa` Forward Rate Agreement (WFRA)



SALIENT FEATURES

Definition

- An Islamic profit rate swap which typically involves an agreement to exchange a floating profit rate for a fixed profit rate or vice versa, implemented through the execution of a series of underlying "*Commodity Murabahah*" contracts.

Objectives

(i) To serve as a hedging instrument in asset and liability management against market risk.
(ii) To be used for arbitraging purposes.

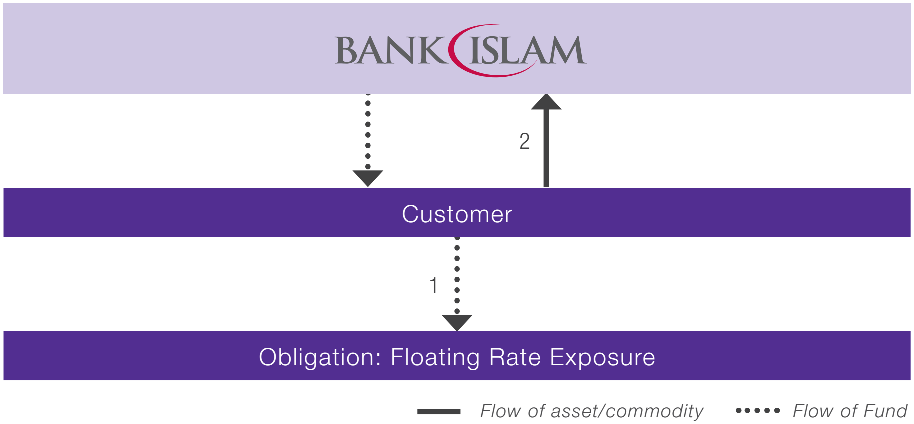
Example

- A customer has a floating-rate financing obligation and wants to hedge this exposure by fixing the profit rate. By entering into the WPRS, the customer can swap its existing obligation (floating rate) for its desired obligation (fixed rate).

1. A customer has a floating rate exposure.

2. By entering into a WPRS with Bank Islam, the customer swaps the floating rate financing cash flow for a fixed rate obligation by receiving floating rate from and paying fixed rate to Bank Islam respectively.

Wiqa` Profit Rate Swap (WPRS)



Bank Islam was the first Malaysian commercial bank to solely lead-arrange and manage the issuance of the US dollar denominated international Islamic securities tradable on an exchange, which was widely accepted by both domestic and international investors. In addition, Bank Islam has undertaken several other notable transactions of which some of the examples are shown in these subsequent pages.





Highlights
On
Islamic
Securities/
Sukuk

Issuer	:	KL International Airport Berhad (KLIA)
Amount	:	RM2.2 Billion
Arranger	:	Bank Islam Malaysia Berhad
Shariah Contract	:	*Bai' Bithaman Ajil (BBA)* - Deferred payment sale

SALIENT FEATURES

- Investors purchase the underlying asset valued at Purchase Consideration.
- Investors subsequently sell the relevant asset to the Issuer at an agreed Selling Price.
- The Issuer issues *BBA* Notes to investors, creating financial obligation of the Issuer to the investors.
- The *BBA* Notes will be redeemed at the maturity date.

Asset Purchase

1. Investors purchase the concession from the KL International Airport Berhad ("KLIA") for a Purchase Consideration.

2. KLIA receives proceeds equivalent to the Purchase Price.

Asset Sale

3. Immediately after the Purchase, investors sell the concession back to KLIA.

4. This creates Selling Price obligations to be paid by KLIA on a deferred basis.

Issuance of Primary & Secondary Notes

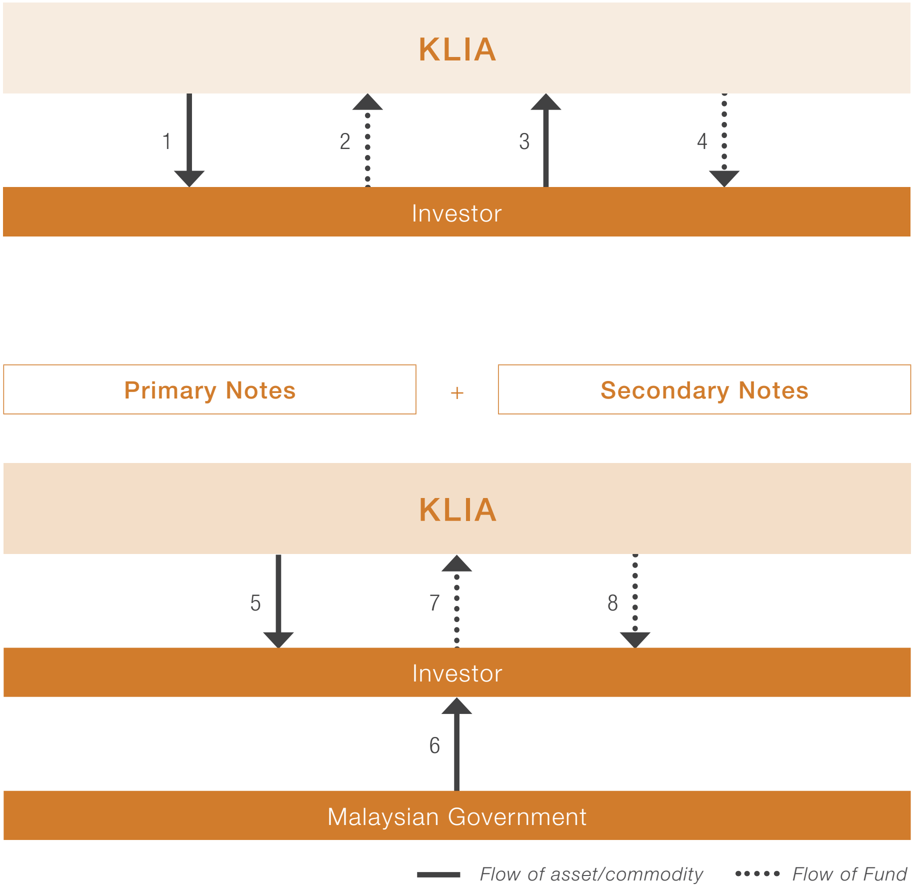
5. KLIA issued Primary & Secondary Notes to investors.
    - Primary Notes represent the Cost Price. Redemption tenor is structured to match the maturity date of the Notes.
    - Secondary Notes represent the Profit and is not detachable from the Primary Notes. Its redemption tenor is structured to match the series of periodic return payment of the Notes.

6. The Malaysian Government guarantees the Notes issued by KLIA.

7. Investors pay the Cost Price of the Notes.

8. KLIA redeems the Primary Notes on maturity and pay periodic returns on Secondary Notes.

BBA Notes Issuance



Issuer	:	First Global Sukuk Inc.
Amount	:	USD150.0 Million
Sole Lead Arranger	:	Bank Islam (L) Ltd
Shariah Contract	:	*Ijarah* - Contract of Lease

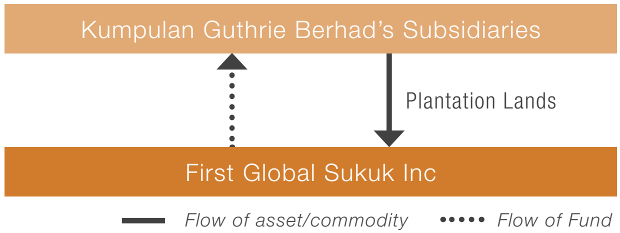
SALIENT FEATURES

- The *Sukuk*/Trust Certificates represent the undivided ownership in the trust assets created pursuant to the *Ijarah Sukuk* issuance.
- It involves the transfer and leases of beneficial rights of the assets.
- Investors hold the *Sukuk* under Trust.
- *Sukuk* is tradable on the secondary market.
- On maturity, the beneficial rights are transferred back to the Issuer.

SUMMARY OF FIRST GLOBAL SUKUK INC (SUKUK IJARAH)

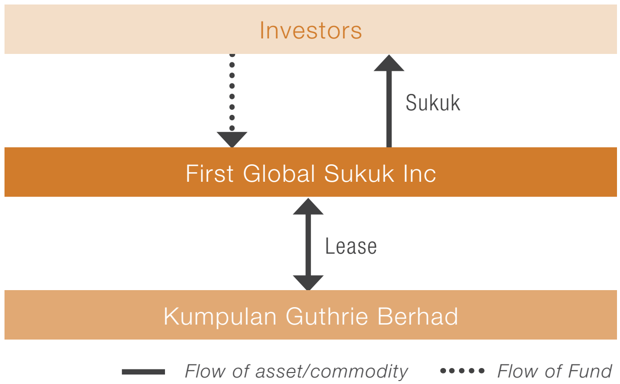
Asset Purchase

The SPV, First Global Sukuk Inc purchases plantation lands from Kumpulan Guthrie Berhad's subsidiaries.



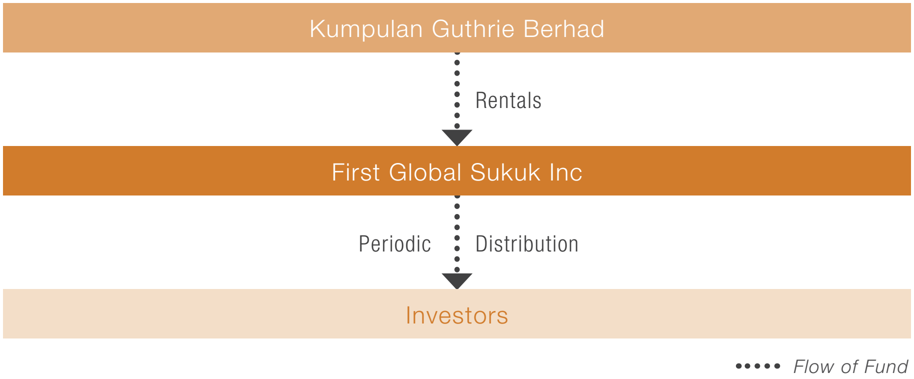
Sukuk Issuance

The SPV issues *Sukuk* to investors to finance the purchase of the plantation lands. Each *Sukuk* represents a fraction of the undivided ownership of the plantation lands. The SPV enters into lease arrangement with Kumpulan Guthrie Berhad.



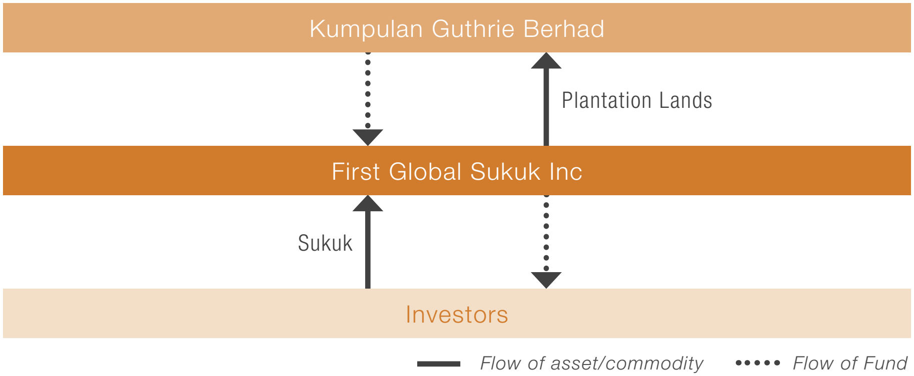
Periodic Distribution Date

The SPV will pass through the periodic rental proceeds received from Kumpulan Guthrie Berhad to investors.



Maturity Date

The SPV redeems the *Sukuk* and then sells the plantation lands to Kumpulan Guthrie Berhad. The proceeds of the disposal shall be utilised to pay for the redemption of the *Sukuk*.



Issuer	:	Manfaat Tetap Sdn Bhd
Amount	:	RM752.2 Million
Bank Islam Malaysia Bhd	:	Shariah Advisor
Shariah Contract	:	*Mudharabah* - profit sharing contract

SALIENT FEATURES

- The Issuer, Manfaat Tetap Sdn Bhd, is a SPV owned by System Lingkaran Lebuhraya Kajang Sdn Bhd (SILK).
- The SPV becomes *Mudharib* 1 (for *Mudharabah* 1) and *Rabbul Mal* 2 (for *Mudharabah* 2) and lessor on assets leased to SILK.
- *Mudharabah* Sukuk issued under *Mudharabah* 1 are not transferable nor tradable.
- The Issuer uses the capital from *Rabbul Mal* (under *Mudharabah* 1) to purchase Ijarah assets from SILK and to invest in SILK under *Mudharabah* 2.
- *Al Ijarah Thumma Al Bai*' (AITAB) contract is executed between the Issuer and SILK.
- Investors (and Issuer under *Mudharabah* 2) will receive profit distribution annually based on an agreed profit sharing ratio. Under the *Ijarah* contract, SILK will pay a fixed rental amount to the Issuer semi-annually.

TRANSACTION STRUCTURE OF MANFAAT TETAP SDN BHD MUDHARABAH SUKUK

1. Investors enter into a *Mudharabah* venture (known as *Mudharabah* 1) with the Issuer where Investors will contribute an amount of capital to the Issuer.

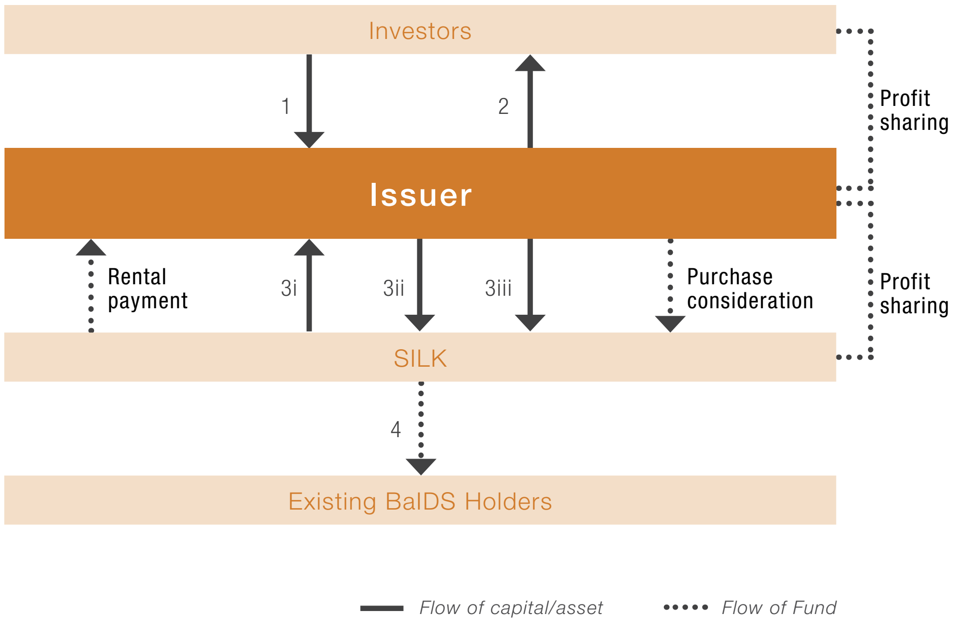
2. The Issuer, in return, issues *Mudharabah Sukuk* to Investors as an evidence of Investors' investment.

3i. Upon receipt of capital contribution from Investors, the Issuer enters into Asset Purchase Agreement with SILK to purchase the SILK's assets at an agreed price.

3ii. The Issuer thereafter enters into an *Ijarah* Agreement to lease the assets to SILK in return for periodic Ijarah rental payments.

3iii. Parallel to the *Ijarah* Agreement, the Issuer utilises part of the capital contributed by the Investors to enter into *Mudharabah* 2 agreement with SILK, where in, the Issuer provides capital contribution for the business of SILK.

4. Proceeds received by SILK pursuant to the sale of Ijarah assets and capital contribution under *Mudharabah* 2 will be utilised as full and final settlement to the existing BaIDS holders.


Investors
1
2
Profit sharing
Issuer
Rental payment
3i
3ii
3iii
Purchase consideration
Profit sharing
SILK
4
Existing BaIDS Holders
Flow of capital/asset
Flow of Fund

For more information on Shariah contracts application in Bank Islam's products and services, please contact:

Product Development Department: 03 - 2088 8070 / 8063 / 8064
Shariah Department: 03 - 2088 8047 / 8052
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